FY07 – FSA Frequently Asked Questions

What is a flexible spending account, and why is it beneficial?
A flexible spending account (FSA) enables you to pay for certain eligible medical and dependent/day care expenses with pre-tax contributions. By making pre-tax contributions, you reduce your taxable income and therefore your income tax liability. Your contributions are actually called a "salary reduction" because your salary is reduced by the contribution amount before you are taxed.

Your contributions are deposited directly into account under your name. Your claims are then paid directly to you from this account with your pre-tax contributions. The benefit to you is that your income tax liability is reduced. For example, if you are in the 22% income tax bracket, you save $22 in income taxes for every $100 you contribute. Or, to put it another way, it's like getting $100 in benefits for every $78 you contribute.

How much can I contribute each Plan Year?
Each Plan Year runs from July 1 through the following June 30. During that time, you may elect to contribute up to the following amounts:

Health Care FSA:	$120 up to $6,000/Plan Year
Dependent/Day Care FSA:	$120 up to $5,000 ($2,500 for a married employee filing a separate federal income tax return).

To determine the amount of your contribution per paycheck, divide your annual election by the number of months following your enrollment until the end of the Plan Year on June 30. You must make separate account elections for health care and dependent/day care. Day care expenses cannot be used to pay for medical expenses of any kind.

If I elect to participate in an FSA, is there any negative effect on my benefits?
Because FSAs reduce your taxable income, your PERA benefits could be reduced. PERA benefits are based on your High Average Salary (HAS), which is calculated by averaging your three highest earning calendar years. Generally, as you progress in your career, your earnings increase. As you get closer to retirement, your may well be in your highest earning years. Therefore, if you are within four years of retirement, you should consider carefully the impact of FSAs on your retirement benefits. We suggest four years, because PERA uses the calendar year while the State's FSA is based on the fiscal year. Pre-tax contributions for medical and dental premiums could also have the same negative impact on your PERA benefits, because they reduce your taxable income in the same way. See What do "Pre-tax" and "After tax" mean?

Can I change my contribution amount or elections during a Plan Year?
FSAs are highly regulated by IRS rules the State's Personnel Rules and the Salary Reduction Plan Document. Generally, your elections are irrevocable. However, changes are permitted if you experience a qualifying change of status listed in US Treasury Reg. 1.125-4, and only if the change you request is consistent with the nature of your change in status and affects eligibility under the plans.

For example, if you get married you can increase your contribution, because it is reasonable to assume that your newly eligible spouse will have additional claims; but you could not reduce your contribution. If you lose a dependent, e.g., through divorce, you could reduce your contribution because your former spouse is no longer eligible and cannot file claims for charges incurred after your divorce.

Qualifying changes in status include:

- changes in marital status (marriage, divorce, legal separation, annulment, death of a spouse);
- changes in the number of tax dependents eligible for coverage (birth, adoption, placement for adoption, marriage, death of a dependent, dependent children reaching the maximum age or losing dependent student status);
- changes in your employment or your spouse's employment (starting/ending a job or leave of absence).
- Refer to "Exceptions to the Irrevocability Rules - Mid-year Changes" and the "Salary Reduction Plan Document" for additional information.

My wife experienced complications during childbirth, and our out-of-pocket expenses were much greater than expected. Can we increase our election to cover the extra expense?
You may increase your election within 31 days of the birth, but your election will go into effect on the first of the following month. The increased amount can be applied only to charges incurred on or after the effective date of your increase. For example, if your monthly contribution to your Health Care FSA was $100 ($1,200 per year) prior to the birth, you could be reimbursed no more than $1,200 for expenses incurred prior to the date your increase went into effect.

When must charges be incurred in order to be eligible for reimbursement?
Charges are incurred on the date you <u>receive</u> a service – not on the date you are billed for the service. Charges must be incurred during the Plan Year for which you are making contributions <u>and</u> while you are a plan participant. Each Plan Year is the twelve-month period between July 1 and the following June 30. Contributions you make during the period July 1, 2006 and June 30, 2007 can be used to pay for expenses you incur during that same period, provided you remain a participant. If you cease participation during a Plan Year, only expenses you incur before you cease participation can be reimbursed.

Are all medical expenses eligible for reimbursement?
No. Only expenses that meet the definition of "medical care" under Section 213(d) of the Internal Revenue Code (except insurance premiums and long-term care expenses) can be reimbursed. Services must be performed "for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body".

Cosmetic procedures are covered only when performed to correct birth defects, treat a disfiguring disease, or treat deformities arising out of accidental injury or trauma. See IRS Publication 502 regarding medical and dental expenses on the IRS web site at:

http://www/irs.gov/pub/irs-pdf/p502.pdf. This list may change periodically, so you may wish to review it occasionally.

Eligible charges not paid by your medical/dental plan are reimbursable through an FSA, including: deductibles, coinsurance and copayment amounts. In addition, certain over-the-counter medications not covered by your medical plan are reimbursable under an FSA. Those medications include: cold medicines, fever and pain medicines like aspirin, heartburn/stomach/digestive relief items, eye care items (including contact lens solution) and others. Such See the Plan Document for more information.

A number of over-the-counter products do not qualify for reimbursement, including: vitamins (except for prescription pre-natal vitamins), nutritional supplements, herbs, cosmetic supplies like blemish cream, band-aids and general hygiene items (toothpaste, floss, dandruff shampoo, et al.).

Are all dependent care expenses eligible for reimbursement?
No, but expenses that qualify for the Child Care Credit under Section 21(b)(2) of the Internal Revenue Code will qualify for reimbursement. If you pay someone to care for a **child under the age of 13** or for a family member that cannot care for him/herself (e.g., a disabled or elderly adult tax dependent), the cost of care may be reimbursed from your dependent care flexible spending account. No medical expenses at all can be reimbursed through a dependent care account, even if those medical expenses are incurred by a dependent.

Only those expenses that enable you and your spouse (if any) to work are reimbursable. More detailed information is found in IRS Publication 503, located at: http://www.irs.gov/pub/irs-pdf/p503.pdf. This list of eligible charges changes periodically, so you should review occasionally. If you file for the child-care tax credit on your federal income tax return, you may still be eligible to participate in the dependent care flexible spending account, depending on your income level and the amount of care expenses you expect to incur. Consult your tax advisor before making an election.

How do I file claims for reimbursement?
Our FSA plan is administered by ASI, whose website is www.asiflex.com. From the web site, you can download the appropriate claim form, and send it to the address shown on the form. Be sure to submit all required receipts and information to avoid delays in processing your claims. When filing claims for over-the-counter medications, be sure that your receipt states explicitly the name of the medication for which you are claiming reimbursement. No claim is considered complete and received without supporting documentation.

Is there a deadline for filing claims?
Yes, regardless of the postmark date, claims incurred during a Plan Year and while you are a plan participant must be **received** by ASI no later than **October 15** following the end of the Plan Year on June 30. For example, claims incurred during the period July 1, 2006 through July 31, 2007 must be received by ASI on or before October 15, 2007. If October 15 falls on a non-work day, the deadline would be the next following workday. Claims incurred after July 31, 2007 will

be eligible for reimbursement from the following year's FSA, provided you are properly enrolled in the Plan. ASI date-stamps each claim as it is received, and this stamp is the receipt of record.

- *Important Note*: A claim is considered received when all required receipts and documentation are received. For example, if a claim form is received on October 14 but receipts are not received until October 16, the claim would be considered late and would be declined.

Delays in US Mail delivery do not warrant an extension of the claim-filing deadline. To avoid a late filing claim denial, you should submit your claims as early as possible and all through the Plan Year. However, if delayed filing is unavoidable, you should consider faxing your claim to the fax number shown on the claim form, and you should retain the confirmation of receipt. Or, you should consider sending your claim *via* overnight mail with return receipt so that all required documentation is confirmed as received by October 15. You alone are responsible for the timely filing of your claims.

Account balances are forfeited at the end of the Plan Year. Why can't they be returned to me, or rolled over to the next Plan Year.
The State's Salary Reduction Plan is intended to comply with IRS Rules and Regulations, including Section 125 of the Internal Revenue Code. Section 125 requires the forfeiture of unused account balances at the end of a Plan Year. This is the well known "use it or lose it" rule, and is a requirement of all tax-qualified flexible spending account plans.

I've heard that we can have up to two and one-half additional months to incur claims. Can we do that?
Not at this time. Even though the IRS now permits plans to provide a grace period of two and one-half additional months to incur claims, the IRS has not issued sufficient guidance regarding the administration of this new grace period. In order to safeguard the plan and its participants by avoiding potential violations of regulatory requirements, the State has elected not to implement this grace period until we can assess the IRS' guidance. Once those regulations are issued, we will review them and assess whether the grace period is appropriate for our plan. However, even with the additional two and one-half months to incur claims, the "use it or lose it" rule is still in effect for the forfeiture of contributions that remain unused by the end of the grace period or for claims that are filed late. The grace period does not end "use it or lose it."

Are Health Reimbursement Accounts (HRAs) the same as FSAs?
No, HRAs are not the same. Unlike FSAs, HRAs are not subject to Section 125. Another difference is that HRAs can be funded with employer contributions, but FSAs must be funded with employee contributions through salary reduction. HRA account balances can be carried forward to the next plan year, and so can the Health Savings Account (HSA) option, which is available to State employees who enroll in the PPO-H Option.

May I enroll for both a Health Care FSA and an HRA?
No, IRS Rules and Regulations do not permit you to enroll for both. You could enroll for a Dependent Care FSA, but not for the payment of any medical claims. If you enroll for an HRS, only the Dependent Care FSA screen will appear on the enrollment system. Do not enroll for

Dependent Care unless you have eligible dependents in need of eligible day care services. You will not be able to change your election, and you will forfeit your contributions.